KEVIN HOLLINRAKE MP

HOUSE OF COMMONS

LONDON SW1A 0AA

António Horta-Osório
Chief Executive
Lloyds Banking Group
10 Gresham Street
London EC2V 7AE

21st November 2018

Dear Mr. Horta-Osório,

The Lloyds Banking Group (LBG) press statement of 14th November 2018 confirms that Sally Masterton who was employed as a senior risk officer in the Group "acted with integrity and in good faith at all times" and that her concerns were "documented following a request from the Group". In previous correspondence with your group, the APPG has expressed serious concerns about the way in which the bank has mistreated Sally Masterton and has dealt with the very grave allegations of a cover-up of fraud within your group during the period of your tenure. The 'Project Lord Turnbull Report' that Sally Masterton wrote, dated September 2013, includes the following statements within the Executive Summary:

- *Proper disclosure of the Reading Incident (the fraud) in July 2007 would have rewritten history for HBoS, Lloyds TSB and the Government.*
- *HBoS should have been a gone concern in February 2008. It was hopelessly insolvent by July 2008.*
- *The strategy since January 2007, and possibly from 2005, has been to conceal the Reading Incident.*
- *Concealment set in motion a course of events that has and continues to have far-reaching and very serious consequences, extending to the Lloyds TSB takeover. LBG is significantly exposed.*
- *Substantial loss has been caused to HBoS ordinary shareholders (to July 2007), the subscribers to the HBoS 2008 Rights Issue (£332m) and to Lloyds TSB shareholders (£14bn) as a result of the actions of those involved. Compensation due to HBoS customers who were directly affected by the Reading Incident may be significant.*

As you know, the fraud itself was successfully prosecuted in 2017. It is abundantly clear from the evidence we hold that you were made aware of the existence of a fraud as early as 2011. For the avoidance of doubt, our concerns relate to the allegations of the cover-up of the fraud rather than the fraud itself. I would like to understand how it is that, despite the fact you were aware of Sally Masterton's findings, you did not oversee a thorough investigation of the allegations of the "concealment of the Reading Incident" within your own organisation. Indeed, it is a matter of record that your organisation, Lloyds Banking Group, first suspended and then dismissed her, sought to discredit her and knowingly prevented her from assisting the police.

Your statement attests that the "Project Lord Turnbull Report was provided to the regulator and the police in 2014". In a letter to the FCA on 07 Oct 2013 Lloyds Group General Counsel Andrew Whittaker agrees that the allegations are "very serious and wide-ranging" yet he advises that "LBG is not persuaded......it would be appropriate to conduct another wide-ranging investigation based on allegations made by Mrs Masterton". The word "another" refers only to a separate and unrelated issue

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of a human resources nature and should have not been used to question Sally Masterton's competence or integrity and to attempt to discredit her to the FCA.

On 30 July 2014 Herbert Smith Freehills LLP wrote on behalf of LBG to the Crown Prosecution Service. This letter specifically states that the report was "not commissioned by LBG. Rather it was undertaken by Sally of her own volition".

In a letter to the FCA on 08 May 2014 Lloyds Group General Counsel Andrew Whittaker states that LBG was not persuaded that it would be an appropriate use of time and money to investigate "in the light of the outcome of the previous investigation and its evaluation of the *credibility* of Mrs. Masterton".

The report contains internal e-mails between Ian Goodchild, Deputy Head of Credit and Peter Hickman, Group Risk Director, in February 2008 that relate directly to "the fraud", therefore we fail to see why Andrew Whittaker describes the allegation as "unparticularised", effectively choosing to dismiss the report as unsubstantiated.

The bank has maintained publicly that they had seen 'no evidence of criminality' prior to the criminal convictions in February 2017. Indeed, it has based its entire compensation scheme on this fact.

However, Paul and Nikki Turner detailed the issues to you in the following letters. In the interests of brevity, I have focused on your tenure rather than the years before your tenure, during which the fraud was known:

- To Sir Win Bischoff on 18 May 2010 with a detailed breakdown of the fraud, which is later referenced in letters to you
- To you on 11 April 2011, 18 May 2011, 17 January 2012
- To Juan Colombas, Chief Risk Officer, on 19 April 2012 and 08 June 2012

The bank responded to these letters and assured the Turners that both you and the board were fully briefed on the HBOS Reading affair and were aware of the full contents of the letter of 18 May 2010. There had also been a parliamentary debate and a BBC documentary, and nine arrests had been made by this time. It is, therefore, clear and had been confirmed that you were briefed not just on the fact that there was an investigation but on the detail.

We also understand, following a report by Jonathan Ford in the Financial Times of 26th September 2018 that Lloyds Banking Group frustrated a request from police to continue to work with Sally Masterton to uncover details of the fraud. The request was made by Detective Inspector Tim Hurley by way of an email sent in July 2013 to Sue Harris, LBG audit director.

According to Mr Ford *"Mr Hurley stressed that Ms Masterton, who had previously helped the police with their investigation, had unique knowledge of the case and an ability to distil complex banking concepts into language comprehensible to a lay person. This, and her ability to locate relevant evidence in the bank's files, made her "vital to the ongoing investigation", he wrote in the email, seen by the Financial Times. "This knowledge would be lost if another person were allocated to perform such a role".*

After the email was sent it is thought that Ms Masterton had no meetings with the police. And within weeks of Lloyds receiving the email she had been relieved of her duties in unexplained circumstances

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and placed on enforced leave. This meant she no longer had access to information and data held in the bank's systems. She left Lloyds in the summer of 2014 without returning to work. She had signed a compromise agreement, with a gagging clause."

We are also aware that during her police interviews, the bank chose to 'brief' Sally before and after each meeting by Freshfields LLP and provide guidance on what she could and could not discuss. Specifically, she was told only to provide answers to specific questions and that she was not to carry on with her own investigations nor 'offer up' information that the police did not specifically ask for.

Please could you answer:

- What action did you take to establish the accuracy of the fraud allegations contained within the report?
- What investigations did you carry out into the fraud cover-up and other allegations contained in the Executive Summary of the report?
- Why did LBG deny that they had requested that Sally Masterton document her concerns?
- Why did LBG state to the FCA that Sally's actions were not sanctioned by the bank and that there was no substance to her report?
- Why did LBG set out to destroy Sally Masterton's reputation and credibility?
- Why did LBG ignore the requests of Thames Valley Police officers who were investigating the HBOS fraud to have continued access to Sally Masterton and instead suspend her from her duties?
- Is it still LBG's position that no evidence exists to substantiate the report?

I will also write to the FCA on this matter to ask them to open an investigation of these events under the Senior Managers and Certification Regime. I look forward to hearing from you.

Yours sincerely,

Kevin Hollinrake MP
Co-Chair of the All-Party Parliamentary Group on Fair Business Banking

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Miller, David (Managing Director, Credit Sanctioning)

From:	Livingston, Stewart (Chief Risk Officer, Corporate)
Sent:	11 February 2008 21:05
To:	Miller, David (Managing Director, Credit Sanctioning)
Subject:	Fw: Reading Exco Paper
Attachments:	Reading Update Feb08 (5) - IG+ SC comments.doc

Reading Update Feb08 (5) - IG+...

David

Please do not circulate given sensitivity but can you get somebody to pull together urgently what Peter is looking for and also if poss address the Turnbull issue.

Tks

Stewart

----- Original Message -----
From: Hickman, Peter (Group Risk)
To: Livingston, Stewart (Chief Risk Officer, Corporate)
Sent: Mon Feb 11 19:50:14 2008
Subject: FW: Reading Exco Paper

Stewart
Thanks for your help on this - especially the higher level learnings and the likely inherent losses before the rogue behaviour which I believe youare helping us with. The latter is also important for the Audit Committee - our Turnbull cut-off is £285m but that is not a hard limit and we are uncomfortably close to that at £265m - anything we can do to widen the gap between this loss and that limit will help us convince the Audit Committee we should not disclose - something we seriously do not want to do - especially at the moment.

Could I also ask for your help - I cannot stop at the response that seems to have come back that producing a chart of how this rogue behaviour evolved "is too difficult to produce" in Ian's note - this is too important for ExCo's understanding of how this evolved and frankly I would have expected us to have understood this (probably supports what you and I discussed about the investigation sensitivities) - I am happy to be flexible about how we illustrate this e.g if we tracked the further advances on the 23 loans where we have made substantial provision since 2004 as a proxy then that would do (I hope we can access from the system a history of when advances were made but maybe they are even worse than I thought!). Could you please help me by getting someone urgently to pull together some appropriate information which will give some indication of how this developed and to liaise with Ian as appropriate.

PLease give me a call if you want to discuss. I also attach the latest draft of the report - could you also check that this report is not misleading given your concern that the review was not comprehensive (e.g the real estate loan).

I presume this needs to go to Co Secs on Tuesday night / wednesday morning.
Regards

From: Goodchild, Ian (Group Risk Credit)
Sent: 11 February 2008 18:51
To: Hickman, Peter (Group Risk)
Cc: Thompson, Tim (Group Risk); Clark, Steven (Group Risk - Credit)
Subject: FW: Reading Exco Paper

Peter

Please find attached a Revised draft of the Reading Exco / Audit Committee paper.

Unfortunately, we have had difficulty in getting input from Corporate in two areas

* The introductory paragraph you asked for from Corporate to set out the higher level lessons learned - what has it told them about the culture, organisation, MI and supervisory processes within Corporate and how have they responded holistically.

* The chart on how the extent of the problem evolved over time.

Corporate advise the chart is too difficult to produce and we are waiting on Stewart for the paragraph. Stewart has unfortunately been 'back to back' since Friday, although his PA is trying to catch him this evening. We hope to get something we can insert tomorrow.

I would also draw to your attention:-

* The 11 cases presently viewed as requiring no extra provision could generate additional charge in the range £0 - £22M. It is felt it is likely to be at the lower end of this range, but £0 is unlikely. We have not explicitly stated this in the report, but we should perhaps expect modest additional provision of up to few million.

* You asked about our best estimate of the likely underlying credit losses. We believe that £50 - £100M of the £266M would have a happened anyway had the fraud not occurred- suggesting an incremental loss of £166m - £216M. We are waiting for Stewart to confirm this.

* We have left the comment about Group Operational Risk not detecting the High Risk control environment in the self assessment exercise that you previously deleted in, but have explained the control weakness more fully.

On the last point, there may be a wider issue we need to consider. At present, Group Credit's activities would not generally be directly focussed on detection of control weaknesses leading to fraudulent management of customers accounts, or on such fraud losses themselves- either in Corporate or in any other Division. The sampling approach Group Credit previously applied to provisions was focussed on determining that the level of provision was appropriate, assuming that the underlying MI was accurate to guide us. Clearly the sampling one would consider to detect fraud would be quite different, and potentially more complete and onerous than simply to check the appropriateness of the provisions themselves. Whilst we have stated in this report that we will amend the approach to ensure that we would pick up issues of this nature in Corporate going forward, if we were to conduct reviews to provide similar assurance in other areas of the business it would become a significant additional activity for Group Credit. I am also not sure how this would overlap with Group Operational Risk or Financial Crime activity and where responsibility lies. Is this something I should take up with Jack and Alasdair?

Regards

Ian Goodchild
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From: Clark, Steven (Group Risk - Credit)
Sent: 11 February 2008 17:38

To: Goodchild, Ian (Group Risk Credit)
Cc: Dickson, Stuart (Group Risk - Credit)
Subject: RE: Reading Exco Paper

Ian

Reading paper attached for review & onward to Peter. Comments on the parts not included:

I have been unable to speak directly to Stewart today although have spoken to his PA - appears he has . She will try and speak to him before he leves the office tonight and revert. In terms of the introductory paragraph in Section 5, I know you mentioned we could draft but this surely has to come from 'within' / Corporate themselves to have any meaning/ownership?

We have removed reference to the c£22m figure previously inserted re potential for further loss in 2008. This number is viewed as a worse case scenario (aggregation of) as the remaining work-outs complete - the year end provisions are based on recoveries completing as expected / current knowledge which is consistent with normal practice.

In Section 3, Tom Angus has advised the 'situation develops' chart is not available (in the time available) - I suspect it would take a manual trawl through all the files and related systems over the years involved - probably a week or more in man days

For clarity, the £266m is not solely down to the Scourfield / control issues - a majority of the accounts were already high risk / impaired and losses would have ensued if events had been normal. Tom Angus has put a guestimate figure of up to £100m against this, but doesn't want quoted at Exco etc without validation by SL. Even if this was scaled back to say £70m, it would keep the Reading 'impact' under £200m. This may be important for Turnbull.

Steven

From: Goodchild, Ian (Group Risk Credit)
Sent: 11 February 2008 12:38
To: Clark, Steven (Group Risk - Credit)
Subject: FW: Reading Exco Paper

Ian Goodchild
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Group Risk - setting the standard

From: Goodchild, Ian (Group Risk Credit)
Sent: 08 February 2008 16:48
To: Livingston, Stewart (Chief Risk Officer, Corporate)

Cc: Mcgregor, Ross (Group Risk - Credit)
Subject: Reading Exco Paper

Stewart

We are trying to finalise the Reading paper Peter Hickman requested for Exco.

Your teams have been really helpful in providing us with information to go into the paper, but there are a final couple of areas where we are struggling, and I wonder if you can help.

1) Peter has asked for a "an introductory paragraph from Corporate which sets out the higher level lessons learned - what has it told them about the culture, organisation, MI and supervisory processes within Corporate and how have they responded holistically" . Would you be able to provide us with some lines?

2) Tom has indicted off the record that he estimates the underlying credit losses to have been c£100M. This would suggest an incremental impact of c £150M? Would you be happy for us to put these figures in the Exco / Audit Committee paper as Corporates best view of the additional losses?

Many thanks

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Group Risk - setting the standard

From: Harris, Sue (Group Audit Director)
Sent: 17 July 2013 12:48
To: Masterton, Sally (Credit Intelligence); Ahern, Richard (Group Audit)
Cc: 'gillian.eastwood@freshfields.com'; Martin, Gavin; 'Tim.Hurley@thamesvalley.pnn.police.uk'; 'Mick.Murphy@thamesvalley.pnn.police.uk'; Hartridge, Michael (Group Legal, Risk Legal & Secretariat)
Subject: Re: Bringing You Up To Speed

Dear Sally,

I have spoken this morning to Tim Hurley, who I understand also spoke to you yesterday after receiving your e mail.

Tim has been very clear that TVP has not asked you to do any more work. You are therefore entirely free to undertake work in the normal way as requested by LBG. Tim has also confirmed that if there is anything further TVP needs they will make that known to LBG and we will decide how best to handle. This is entirely the proper way for TVP to work with LBG so that we direct our own employees in their work activities.

This is good news Sally, because it now means that you can operate in a business as usual mode with management direction. Given this Sally, it is important that you now complete please the tasks we have previously requested.

As you point out below, cutting and pasting Spayside Angling and Gullen is quick, so please complete that oday and send it to us.

'ou have also previously agreed to let us have cut and paste of your statements: again, please provide those oday.

n respect to the governance issue you raised with me on Friday, please set out what you have found and opies of the documents you have searched for in the shared drives. Please can you confirm that no ocuments in this respect were passed to TVP last week.

/e will consider other tasks once these are completed. Please note that we are not asking you to do any her research at this time, in order that you are freed up to complete these tasks without any further delay.

any thanks

nd regards,

e

m: Masterton, Sally (Credit Intelligence)
Ahern, Richard (Group Audit)
Harris, Sue (Group Audit Director); gillian.eastwood@freshfields.com
llian.eastwood@freshfields.com>; Martin, Gavin; Hurley Tim <Tim.Hurley@thamesvalley.pnn.police.uk>;
phy Mick <Mick.Murphy@thamesvalley.pnn.police.uk>
t: Tue Jul 16 17:29:56 2013

Emails

The 5% arbitrary absolute based on £5,708m was £285m. (Underlying Profit before Tax for Corporate was considerably less at £2,320m.) There are various drafts of the schedule, which were shared with Stewart Livingston, Steven Clark, Ian Goodchild and Peter Hickman. In one exchange of Emails Peter Hickman makes the comment to Stewart Livingston: "We are getting uncomfortably close at £265m. £285m is not a hard limit. Anything we can do to widen this gap will help the Audit Committee not to disclose, and that is something we seriously don't want to do especially at this moment". In another exchange, Peter Hickman raises with Ian Goodchild the issue of reporting the fraud.

The actual Impairment Loss incurred with respect to what has been identified to date as Reading Incident cases is **in excess of £1bn**. An Email from a manager working with Tom in compiling the schedule, queries the accuracy and legitimacy of the schedule, on the basis that it significantly misstated the total Reading Incident Provisions raised to that date (31 December 2007), which the manager says are **c.£800m**.

The schedule Tom Angus was compiling was significantly and knowingly erroneous.

On 11 February 2008 Steven Clark sent an Email to Ian Goodchild attaching another draft of Tom's schedule. That schedule totalled £266m and comment is made that £22m of 2008 Provisions, which had been raised post year end, had been removed from the £266m. It is patently evident from the schedule that even in relation to the connections on the schedule, significant further Provisions would be required. Steven knows the schedule is wrong and in what seems to be an attempt to force proper disclosure makes reference to the Turnbull Guidance.

Ian Goodchild then sent an Email to Peter Hickman copied in to Tim Thompson (new Head of Group Credit Risk) and Stuart Dickson. Ian points out about the additional but excluded £22m. He further asks Stuart to provide an estimate of the amount of loss that would have been incurred in any event, if the "fraud" had not been committed. He does not point out about the £500m+ that had been excluded!

The schedule submitted on 14 February 2008 totals £262.4m. The schedule is very clearly incorrect.

Report to the Audit Committee: February 2008

The report ultimately presented to the Audit Committee in February 2008 shows the 2007 Impairment Provision Charge for 27 of the Reading Incident cases as being £266k. The report does however point out that Provisions amounting to £78m had been excluded. The basis of the £78m is unknown and there are clearly significant additional Provisions over and above this that were not included. Nevertheless at £344m, this was above Peter Hickman's initial arbitrary materiality threshold for disclosure.

The report summarises the findings and lessons learned from the July 2007 Group Credit report (Risk Review of the Credit Limit Control Environment) and provides an update on the various initiatives that came out of the review.